

**Before the
Federal Communications Commission
Washington, DC 20554**

In the Matter of	§	
	§	
In the Matter of Accounting Safeguards	§	CC Docket No. 96-150
Under the Telecommunications	§	
Act of 1996:	§	
	§	
Section 272(d) Biennial Audit Procedures	§	

Comments of the Public Utility Commission of Texas

<u>I.</u>	<u>EXECUTIVE SUMMARY</u>	2
<u>II.</u>	<u>INTRODUCTION</u>	3
<u>III.</u>	<u>GENERAL COMMENTS AND BACKGROUND</u>	5
<u>IV.</u>	<u>SPECIFIC COMMENTS ON THE AUDIT REPORT</u>	9
<u>IV.</u>	<u>CONCLUSION</u>	15

I. EXECUTIVE SUMMARY

After reviewing the final audit report of the first full year's Section 272 activities, the Texas PUC finds itself unable to determine whether SBC has met all the requirements regarding the interactions between itself and its Section 272 affiliates. In some areas of the audit report, the auditor provided insufficient information. For example, when the audit report states that the auditor obtained "relevant information," that information is not summarized, identified, or reported but is instead buried in extremely voluminous audit work papers. Similarly, though the primary focus of the audit was correctly on the interactions between SBC and its Section 272 affiliates, these are not the only types of transactions that implicate the safeguards contained in Section 272 of the Act and related FCC rules. SBC makes use of corporate-support-services organizations that support the operations both of SBC and its Section 272 affiliates. These organizations provide many mission critical functions to the SBC subsidiaries such as billing, accounting, legal services, human resources and training, etc. The failure of this audit to address and report on the scope and nature of these support services gives an incomplete picture. Lastly, the audit itself had some clear flaws. Several examples of these are set forth in Part IV of these comments.

Flaws with the current audit should be rectified before the audit report is considered complete and comprehensive. Also, given that the next biennial audit is already underway, the Texas PUC requests that the FCC enforce a more thorough audit of the Section 272 requirements and that the findings of the review be fully explained in the final audit report. Lastly, on December 23, 2002, the FCC allowed the Section 272 requirements for Verizon in New York to sunset by operation of law. Should the FCC continue this practice, SBC's Section 272 obligations in Texas to provide interexchange services through a Section 272 affiliate will end by operation of law on July 1, 2003. If the FCC permits this to occur, it will do so without the benefit of knowing whether there has been compliance with the requirements of Section 272 and will do so without factual consideration of whether, based on the existence of sufficient audit data, these requirements should be lifted.

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On October 31, 2002, the Federal Communications Commission (FCC) released a Public Notice entitled “Enforcement Bureau Seeks Comments on SBC Communications Section 272 Compliance Biennial Audit Report in CC Docket 96-150.” In this Notice, the FCC requests comment regarding the report.

The Public Utility Commission of Texas (Texas PUC), having general regulatory authority over public utilities within our jurisdiction in Texas, submits these comments in response to the Notice.

II. INTRODUCTION

Pursuant to Section 271 of the Telecommunications Act of 1996¹ (“the Act”) the FCC has authorized SBC Communications, Inc. (“SBC”) to enter the in-region interLATA market in Texas, as well Kansas and Oklahoma.² Section 272 of the Act requires Bell operating companies to offer in-region, interLATA service through separate affiliates that comply with certain structural,

¹ 47 U.S.C. § 271.

² *Application by SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region InterLATA Services in Texas*, CC Docket No. 00-65, Memorandum Opinion and Order, 15 FCC Rcd 18354 (2000) (*SBC Texas 271 Order*); *Joint Application by SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Kansas and Oklahoma*, CC Docket No. 00-217, Memorandum Opinion and Order, 16 FCC Rcd 6237 (2001) (*SBC Kansas/Oklahoma 271 Order*).

nondiscrimination, and accounting safeguards.³ Section 272(d)⁴ requires a biennial audit to determine compliance with this section and the rules promulgated thereunder.⁵ These comments pertain to the biennial audit report (audit report) of SBC's first year of operations in Texas and partial year in Kansas and Oklahoma. The audit report was submitted by Ernst & Young, LLP (Ernst & Young, or the auditor) on December 17, 2001.

As noted, *supra*, the biennial audit is required by Section 272(d) of the Act.⁶ In the case of SBC's Section 272 affiliates, the period identified for this audit was July 10, 2000 to July 9, 2001. The dates selected were based on the first date SBC could offer interLATA service in Texas, the first SBC-served state in which SBC was granted such authority. Subsequent audit periods are expected be two years each, examining a period that commences July 10th of one year and terminates July 9th two years later.

Pursuant to Section 272(d)(1) of the Act, SBC is required to "obtain and pay for" a joint Federal/State audit every 2 years "conducted by an independent auditor" to determine whether it "has complied with this section and the regulations promulgated under this section, and particularly whether such company has complied with the separate accounting requirements under subsection (b)."⁷ Under FCC rules, the independent auditor must conduct the audit according to the procedures approved by the FCC and representatives from the 13 states⁸ where SBC operates.⁹ The representatives from the FCC and the states' regulatory agencies comprised

³ 47 U.S.C. § 272.

⁴ 47 U.S.C. § 272(d).

⁵ See *Implementation of the Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, Report and Order, 11 FCC Rcd 17539 (1996) (*Accounting Safeguards Order*), Second Order On Reconsideration, FCC 00-9 (rel. Jan. 18, 2000); *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905 (1996) (*Non-Accounting Safeguards Order*). These safeguards are codified at 47 C.F.R. §§ 53.1-53.213 (2001).

⁶ 47 U.S.C. § 272(d).

⁷ 47 U.S.C. § 272(d)(1).

⁸ The states are: Arkansas, California, Connecticut, Illinois, Indiana, Kansas, Michigan, Missouri, Nevada, Ohio, Oklahoma, Texas, and Wisconsin. Representatives from Nevada and Michigan did not participate with the Joint Oversight Team.

⁹ 47 C.F.R. § 53.209(d).

the Joint Oversight Team. The Joint Oversight Team was chaired by a representative from the FCC and the representative from the Texas PUC acted as the States' Coordinator.

The Joint Oversight Team elected to use the Agreed-Upon Procedures (AUP) form of attestation engagement to meet the objectives specified in the Commission's rules, *i.e.*, to determine whether the BOC and its section 272 affiliates complied with the relevant accounting and non-accounting safeguards. The Team also reviewed the performance of the audit as well as the draft auditor's report and the audit working papers used.¹⁰ The AUP and the audit report reflecting them were broken down into eleven Objectives and corresponding Procedures. The Objectives were each intended to express requirements contained in Section 272, the Accounting Safeguards Order, and the Non-Accounting Safeguards Order. The Procedures set forth particular inquiries for the auditor to make, including procurement of documents, questions to SBC management, and other standard auditing procedures.

III. GENERAL COMMENTS AND BACKGROUND

After reviewing the final audit report of the first full year's Section 272 activities, the Texas PUC is unable to determine whether SBC has met all the requirements regarding the interactions between itself and its Section 272 affiliates.¹¹ As pointed out by the Joint Federal/State Oversight Team (Joint Oversight Team), in some areas of the audit report, the auditor provided insufficient information. For example, when the audit report states that the auditor obtained relevant information, that information is not summarized, identified, or reported. Rather, the information is buried in extremely voluminous audit work papers. Similarly, though the primary focus of the audit was correctly on the interactions between SBC and its Section 272 affiliates, these are not the only types of transactions that implicate the safeguards contained in Section 272 of the Act and related FCC rules.¹² As a large corporation employing economies of scale, SBC has established corporate-support-services organizations

¹⁰ The review of the draft report and the work papers was conducted over a two-week period at the Ernst & Young offices in San Antonio, Texas. The work papers, incomplete at the time, consisted of tens of thousands of pages of information submitted by SBC.

¹¹ "Section 272 affiliates" refers to the following companies, collectively, Southwestern Bell Communications Services, Inc. (SBSCS) doing business as Southwestern Bell Long Distance (SBCLD) and Ameritech Communications, Inc. (ACI).

¹² 47 U.S.C. § 272; 47 C.F.R. §§ 53.1-53.213 (2001).

that support the operations both of SBC and its Section 272 affiliates. These organizations provide many mission-critical functions to the SBC subsidiaries such as billing, accounting, legal services, human resources and training, etc. The failure of this audit to address and report on the scope and nature of these support services provides an incomplete picture.

Significantly, the auditor, Ernst & Young, LLP, was not asked to express an opinion on whether SBC was in compliance with the requirements of Section 272. This was true as well with respect to each Objective of the audit. No conclusions were drawn. The auditor simply summarized, very briefly, the procedures followed with respect to each Objective. In the audit report, Ernst & Young very clearly states:

We were not asked to, and did not conduct an examination, the objective of which would be the expression of an opinion on SBC's compliance with the Section 272 Requirements. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.¹³

Section 272(d) of the Act and FCC rules require that the auditor be independent of SBC. The Texas PUC has some concerns about the "independence" or neutrality of the auditor selected. Ernst & Young, the auditor selected, is the financial auditor for SBC. Though this audit was performed by individuals who are not part of the SBC financial audit group, the question of true independence, in the sense of neutrality and lack of bias, arises. Additionally, the individuals conducting this audit are part of an Ernst & Young office located one block from SBC's corporate headquarters in San Antonio, Texas. Given the many and the very public problems that have manifested over the past year with certain large accounting firms, it is especially important for the FCC and the states to be comfortable that the auditor selected be entirely independent of SBC and unbiased.

The audit was completed by December 2001 with a "final" report submitted to the FCC and the Joint Oversight Team on December 17, 2001. That report had several sections which SBC deemed to be confidential and it requested confidential treatment of portions of the audit report. Not until September 5, 2002 did the FCC deny SBC's request for confidential treatment

¹³ Audit report cover letter.

of the audit report and require the auditor to file the unredacted version of the report within ten days.¹⁴ The audit report was released by the FCC in September 2002.

Many of the deadlines for this audit were not met, so the audit was not completed according to the agreed schedule. The auditor was scheduled to provide a draft of the final audit report to the Joint Oversight Team by September 8, 2001. The Joint Oversight Team had already scheduled a review of the audit working papers to take place September 17 – 28, 2001 in San Antonio. At the time, eleven procedures remained open because SBC had not provided the requested information. The Joint Oversight Team received an incomplete draft report on September 27, 2001. Only the representative from the Texas PUC was able to travel to San Antonio a second time to review the October 2001 draft and the additional working papers for some of the issues that were still open after the Joint Oversight Team concluded its first review of the papers. Because of the lack of timeliness, the entire Joint Oversight Team was not able to review and discuss all the information provided. Some issues were not closed until after the October 2001 date, and some issues were not included in the report but were added to the Joint Audit Team's Comments on the Audit (Attachment A to the audit report).

The FCC must insist upon timely submission of requested materials for all Section 272 audits to ensure necessary analysis by the Joint Oversight Team as well as to ensure timely release of the final audit report. The purpose of the Section 272 audit is to evaluate whether SBC is complying with the requirements of Section 272, the Accounting Safeguards Order, and the Non-Accounting Safeguards Order. As noted by the FCC in its Non-Accounting Safeguards Order, Bell Operating Companies (BOCs) such as SBC are the dominant providers of local-exchange and exchange-access services in their in-region states.¹⁵ A BOC such as SBC may have an incentive to allocate improperly to its regulated core business costs that would be properly attributable to its competitive ventures such as its Section 272 Affiliates.¹⁶ Additionally, a BOC such as SBC may have an incentive to discriminate in provide exchange-access services and facilities that its affiliate's rivals need to compete in the interLATA and information-services

¹⁴ *Accounting Safeguards Under the Telecommunications Act of 1996: Section 272(d) Biennial Audit Procedures*, CC Docket No. 96-150, *Memorandum Opinion and Order*, 17 FCC Rcd 17012 (2002) (*SBC Section 272 Confidentiality Order*).

¹⁵ *Non-Accounting Safeguards Order* at ¶ 10.

¹⁶ *Id.*

markets.¹⁷ Importantly the FCC noted that if a BOC such as SBC charges other firms prices for inputs higher than those it charges itself, then the BOC could create a price squeeze.¹⁸ This could give the BOC an “artificial advantage” that could permit it to win customers even if a competing, unaffiliated carrier were more efficient.¹⁹ It is, therefore, in the interest of the Texas PUC to be sure that SBC is complying with the letter and the spirit of Section 272 of the Act. Lengthy delays in the audit process led to the full Joint Oversight Team being unable to properly evaluate some of the data in this audit. Additionally, lengthy delays in release of the final audit report frustrated the very purpose of Section 272 by hampering the Texas PUC’s as well as the FCC’s ability to timely determine whether SBC is complying with its requirements. FCC and state regulators need to be apprised as soon as possible of any shortcomings uncovered by the audit if they are to take action to mitigate the impact of non-compliance.

The Texas PUC’s concerns regarding the Section 272 audit are heightened by the FCC’s recent actions in regard to sunseting Section 272 requirements by operation of law for Verizon’s operations in New York.²⁰ Under Section 272(f)(1), Section 272 affiliate requirements “cease to apply...3 years after the date such Bell operating company...is authorized to provide interLATA telecommunications services under section 271(d), unless the Commission extends such 3 year period by rule or order.”

On December 23, 2002, the FCC sunset Section 272 requirements for Verizon in New York by issuing a public notice without an order or an opportunity for issues to be raised regarding that decision. Should the FCC continue this practice, the FCC could similarly sunset SBC’s obligation in Texas to provide interexchange services through a Section 272 affiliate by operation of law on July 1, 2003. If the FCC takes such action, it will do so without the benefit of knowing whether there has been compliance with the requirements of Section 272 or factual consideration of whether, based on the existence of sufficient audit data, these requirements should be lifted.

¹⁷ *Id.* at ¶ 11.

¹⁸ *Id.* at ¶ 12.

¹⁹ *Id.*

²⁰ *In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, Memorandum Opinion and Order, released December 23, 2002 (Verizon Order).

Indeed, Commissioner Martin's concurring statement in the Verizon order makes precisely this point. He states that lifting Section 272 obligations without analysis or discussion before the sufficiency of the biennial audit process has been established leaves unanswered questions as to whether such action is warranted. The better course would be for the FCC to require compliance with the audit requirements of Section 272 before considering whether to remove a BOC Section 272 affiliate obligations.

IV. SPECIFIC COMMENTS ON THE AUDIT REPORT

Below are several examples of problems that the Texas PUC has noted with the audit process and report. These are not comprehensive but serve to illustrate some of the problems encountered with the audit report.

A. Objective IX

Objective IX was to:

Determine whether or not the BOCs and an affiliate subject to Section 251(c) of the Act have made available facilities, services, or information concerning its provision of exchange access to other providers of interLATA services on the same terms and conditions as they have to their affiliate required under Section 272 that operates in the same market.

In the Non-Accounting Safeguard Order, the FCC stated that a BOC such as SBC may not discriminate in favor of its Section 272 affiliate in the following manner:

- by providing exchange-access services to competing interLATA service providers at a higher rate than the rate offered to its Section 272 affiliate.²¹
- by not making available facilities and services to others on the same terms, conditions, and prices that it provides to its Section 272 affiliate.²²

This is an important Objective in that it purports to uncover discrimination between SBC's provision of exchange access service to its Section 272 affiliates and such service

²¹ Non-Accounting Safeguard Order at ¶ 16.

²² *Id.* at ¶ 316.

provided to unaffiliated interexchange carriers. As noted by the FCC, if SBC's Section 272 affiliates were offered exchange-access on terms and conditions superior to those available to unaffiliated interexchange carriers, SBC's affiliates could have an "artificial advantage" that could permit it to win customers even if a competing, unaffiliated carrier were more efficient.²³ This could harm competition in the interexchange market.

Unfortunately, the Procedures implemented to address this Objective do not appear to answer the question posed and certainly do not do so in a thorough manner. The Procedures themselves, in particular Procedures 3 and 4, were written broadly enough to have produced sufficient information. It was the auditor's implementation of these Procedures that appears to have led to the relative shortage of information adequate to address the Objective as stated.

Four Agreed-Upon Procedures were set forth to ascertain compliance with these requirements. Procedure 1 required the auditor to obtain from SBC a list of all complaints, federal and state, formal and informal, made to regulators from competitors during a fixed period alleging noncompliance with the Section 272 requirements. No such complaints were found. Though this procedure was agreed upon, meaning that the Joint Oversight Team generally approved it, the procedure is of dubious help in answering the question or Objective posed. Common sense indicates that competitors will rarely be aware of any sweetheart terms or conditions SBC may offer its Section 272 affiliates but not offer unaffiliated carriers. The audit is needed, in large part, for this very reason.

Procedure 2 required the auditor to obtain a list of exchange-access services and facilities with their related rates offered to each Section 272 affiliate and to determine whether SBC made these services and facilities available at the same rates and on the same terms and conditions to all carriers. SBC informed the auditor that its Section 272 affiliates order from the same tariffs as unaffiliated carriers, making additional analysis under this procedure unnecessary.

Procedure 3 required the auditor to:

Obtain invoices for exchange-access services and facilities for one month (to be determined by the Oversight Team after discussing with SBC) rendered by the SBC BOC to the Section 272 affiliate, and other interexchange carriers (IXCs). *Using a statistically valid sample of billed items*, inspect underlying details of invoices and compare rates charged, and terms and conditions applied to each

²³ *Id.* at ¶ 10.

Section 272 affiliate with those charged and applied to IXC's for the same services and note any differences. If differences are noted, pursue the matter further through inquiry of appropriate personnel and note why they occurred. [emphasis added.]

Clearly the usefulness of this Procedure, as well as of subsequent Procedure 4, depends upon the auditor selecting a statistically valid sample of billed items. In this instance, the auditor obtained a listing of all invoices for exchange-access services and facilities by Billing Account Number (BAN), a number used by SBC to designate a customer or customer location that will be billed. The auditor then "randomly selected" 50 BANs out of 502 in all and obtained copies of corresponding invoices. The auditor further selected 100 different Uniform Service Order Codes (USOCs) charged to the Section 272 affiliates. These are codes used by SBC to identify service or equipment for billing purposes. According to the audit report "SBC produced a query of these USOCs with associated rates charged to the Section 272 affiliates and 10 unaffiliated carriers . . . for the month of January 2001."²⁴

Comparing the rates, by USOC, state, and class of service, the auditor found some discrepancies between rates charged to the Section 272 affiliate and rates charged to the 10 unaffiliated carriers. These discrepancies are set forth in Attachment A-8b of the audit. In its December 17, 2001 comments to the FCC and to the auditor, SBC asserted that these discrepancies were statistically insignificant and that the results are misleading. Given that discrepancies were found in the sample, and understanding the importance of nondiscrimination in rates, terms and conditions of exchange access, it is the opinion of the Texas PUC that the auditor should have investigated this matter further. The information provided suggests that there may be some discrimination taking place but does not provide sufficient information to arrive at such a conclusion. Upon uncovering discrepancies in the sample, the auditor should have widened its inquiry under Procedure 3. The agreed upon procedure did not limit the auditor to the examination undertaken, which could have and should have been broader.

Procedure 4 required the auditor to:

Using the sampled invoices obtained in Procedure 3 above, trace the amount invoiced for exchange access services to each Section 272 affiliate and determine whether the amount invoiced was the amount recorded by the SBC BOC and paid

²⁴ Audit Report at p. 33.

by each Section 272 affiliate. For this purpose, identify and inspect method of payment such as cancelled checks, wire transfers, and, if needed, summaries of invoiced amounts corresponding to the amount paid. Note any differences and inquire as to why they occurred.

Procedure 4 required the auditor to use the same statistically valid sample of billed items to ensure that the Section 272 affiliates actually paid the billed amounts. The auditor found that for 25 of the 50 invoices (half), SBC recorded and the Section 272 affiliates paid the amount actually invoiced with one small discrepancy. For 6 of the 50 invoices (12% of the sample), SBC did not provide any documentation of payment. The audit report states “SBCS represented that these invoices did not relate to the Section 272 affiliate and were improperly included in the listing of invoices obtained in Procedure 3 above.”²⁵ It is unclear whether the auditor received this information from SBC itself, the source of the majority of information in the report, or from SBCS – a Section 272 affiliate. “SBCS,” in this sentence, may have been a typographical error. In either case, 6 out of 50 of the original “statistically valid” sample of invoices were, per SBC, improperly included.

Nineteen out of the 50 invoices related to Ameritech Communications, Inc. (ACI), the Section 272 affiliate used by SBC in the former Ameritech states. SBC provided the auditor no payment or receipt documentation for these invoices. According to SBC, these 19 BANs were assigned to Williams Communications, Inc. as of September 30, 2000 and that ACI was no longer responsible for payment of these invoices, which were also improperly included in the “statistically valid” sample of invoices derived in Procedure 3. Thirty-eight percent of the sample fell into this category.

Fully half of the 50 “statistically valid” samples of invoices apparently were irrelevant to this audit. It is untenable that the auditor did not go back and derive a new sample for Procedures 3 and 4. Upon discovering the serious problems with its sample of invoices or BANs, the auditor should have:

- determined why its methodology for establishing a “statistically valid” sample was so deeply flawed; and
- gone back to the drawing board – revising its methodology, selecting a new sample and implementing Procedures 3 and 4 in a manner that produced relevant information valuable for addressing this Objective.

²⁵ *Id.*

The audit report should not be considered complete or comprehensive until this is done.

B. Objective I, Procedure 4

Objective I was to “determine whether the separate affiliate required under Section 272 of the Act has operated independently of the BOCs.” Procedure 4 required the auditor to obtain, from the Section 272 affiliates, a list and description of services rendered to the Section 272 affiliates by the SBC’s other affiliates and by unaffiliated companies.

In meeting the requirements of this procedure, the auditor obtained a list of services rendered to each Section 272 affiliate by SBC’s other affiliates, and by unaffiliated entities. This information was included in the voluminous audit work papers, but the Joint Oversight Team’s request that it be included in the final report was not met by the auditor. The issue boils down to a definition of the word “obtain.” The auditor interpreted this to mean that they received the information from SBC and included it in their work papers. The auditor merely reported that they had received the list. No description of any finding is provided.

The auditor’s statement that they obtained the information is simply insufficient to permit the Joint Oversight Team to determine that the Section 272 affiliate operates independently of SBC. A review of this information is vital to ensure such independence. The work papers are extremely voluminous. Moreover, they are held by the auditor and, other than during the scheduled reviews, unavailable to the Joint Oversight Team members. Merely stating that the information was received is inadequate for the purposes of this audit. Because work papers are not publicly made available, interested parties do not have access to this information for their review and comment. The Texas PUC requests that this information and information like it be fully disclosed for this audit as well as for subsequent audits.

C. Objective I, Procedure 7

As noted, *supra*, Objective I was to “determine whether the separate affiliate required under Section 272 of the Act has operated independently of the BOCs.” Procedure 7 required the auditor to obtain the balance sheet of each Section 272 affiliate as of March 31, 2001 and a detailed listing of all fixed assets.

The auditor reported that 119 of 480 assets for Southwestern Bell Communications Systems (SBCS) and 337 of 2,735 assets for Ameritech Communications, Inc. (ACI) were

incomplete. For both, the field identifying from whom or to whom the asset was purchased/sold was not provided. The Joint Oversight Team requested that the auditor provide, as part of the audit report, a listing of all the assets for which this information was not provided along with the dollar amounts for those items. The auditor did not do so claiming it was outside the scope of the procedure.

As stated, *supra*, for Objective 1, Procedure 4, the auditor's merely obtaining the information is insufficient to permit proper evaluation of the question as to total separation of the Section 272 affiliate from the BOC.

D. Objective II, Procedure 4

Objective II was to determine whether the Section 272 affiliate maintained books, records and accounts in the manner prescribed by the FCC that are separate from the books, records, and accounts maintained by SBC. Briefly, Procedure 4 required the auditor to obtain a list of the Section 272 affiliate's financial statements as of March 31, 2001 and a listing of all lease agreements.

In the report, the auditor stated that it had reviewed the financial statements as well as the leases for the Section 272 affiliate. No analysis was made of the information, and it is all included in the audit work papers. The Joint Oversight Team, when reviewing the work papers, found several leases in which the Section 272 affiliate was sub-leasing floor space to the service company at a rate higher than it was paying under its own lease. The Joint Oversight Team requested that this information be added to the audit report. The auditor stated that this was outside the scope of the audit. Further, the auditor stated that a review of transactions between the Section 272 affiliate and the central corporate support organization were not part of this audit.

A proper review of transactions between the BOC and the Section 272 affiliate must include a review of the transactions between the Section 272 affiliate and a central services organization. No such review took place. The services company allocates all its expenses to the companies it serves, in this case including charging some percentage of the lease amount to SBC. This review is to ensure that another corporate party is not being used as a means to subsidize the Section 272 affiliate. Anything less is inadequate.

E. Objectives V and VI, Procedure 12

Objective V was to determine whether the Section 272 affiliate conducted all transactions with SBC on an arm's length basis with transactions reduced to writing and available for public inspection. Objective VI was to determine whether SBC accounted for all transactions with the separate affiliate in accordance with accounting principles and rules approved by the FCC. Briefly put, Procedure 12 required the auditor to address transactions between Section 272 affiliate and the central service organizations.

The auditor stated it obtained the information and conducted a sample review. The Joint Oversight Team found no issue with the sample reviewed by the Auditor. However, the Joint Oversight Team requested that the final report identify the central service organizations that support the Section 272 affiliate and the amounts billed. The auditor stated that it was only necessary for the auditor to "obtain" the list and description. The information is buried in the work papers.

As stated, *supra*, merely obtaining the information is insufficient for proper evaluation of the question as to total separation of the Section 272 affiliate from the BOC.

IV. CONCLUSION

The Texas PUC appreciates the opportunity to comment on the FCC's Notice in this matter. Given that the next biennial audit is already underway, the Texas PUC requests that the FCC enforce a more thorough audit of the Section 272 requirements and that the findings of this review be fully explained in the final audit report. Additionally, in the upcoming audit, SBC must be required to provide the information requested by the auditor on a timely basis. In this

first audit, the Joint Oversight Team noted delays of several months for certain information. The result was that timelines were not met, thus depriving the Joint Oversight Team of adequate time to analyze the data properly.

Respectfully submitted,

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